Gray Davis, Governor
State of California
Business, Transportation and Housing Agency

980 Ninth Street Suite 500
Sacramento CA 95814
916-322-2078

DIRECTOR'S OPINION 01/1

THIS INTERPRETIVE OPINION IS ISSUED BY THE DIRECTOR OF THE DEPARTMENT OF MANAGED HEALTH CARE PURSUANT TO HEALTH AND SAFETY CODE SECTION 1344 OF THE KNOX-KEENE HEALTH CARE SERVICE PLAN ACT OF 1975.

Pursuant to California Health and Safety Code section 1344, the Director of the Department of Managed Health Care (the "Director") has the discretion to issue interpretive opinions resolving questions of law that arise under the Knox-Keene Health Care Service Plan Act of 1975, Health and Safety Code section 1340[1] et seq., as amended (the "Knox-Keene Act"). Prior to July 1, 2000, the authority to issue interpretive opinions regarding the Knox-Keene Act was vested in the Commissioner of Corporations (the "Commissioner"). Subsequent to July 1, 2000, all Knox-Keene Act regulations, orders, or other action adopted or previously taken by the Commissioner transferred to the Department of Managed Health Care (the "DMHC"), and remain in effect and are deemed to be actions of the DMHC. (Section 1341.14.)

Subject to exclusions and exceptions, the Knox-Keene Act makes it unlawful for any health care service plan to engage in business in the State of California without having first obtained a license from the Director. (Section 1349.) Section 1345, subdivision (f)(1) defines a health care service plan as:

> Any person who undertakes to arrange for the provision of health care services to subscribers or enrollees, or to pay for or to reimburse any part of the cost for those services, in return for a prepaid or periodic charge paid by or on behalf of the subscribers or enrollees.

On July 9, 1983, then-Commissioner Franklin Tom issued Commissioner's Opinion No. 4614H (copy attached) in response to a request by the National Benefit Association ("NBA"). NBA provided individual members with multiple buying services at discounted prices in return for payment of an annual membership fee. NBA wished to determine whether the Department of Corporations would deem it as operating a health care service plan if NBA undertook to seek and contract with health care providers who were willing to offer NBA

[1] Subsequent statutory references are to the Health and Safety Code unless otherwise noted.

members a so-called "courtesy discount," i.e., a percentage reduction of the providers' reasonable and customary fee, and to furnish NBA members with a list of such providers.[2]

The Commissioner determined that NBA's proposed activities would make NBA a health care service plan within the meaning of section 1345(f), and that the arrangement it proposed would therefore require NBA to obtain a Knox-Keene license pursuant to section 1349. The Commissioner stated:

> NBA, by contracting with dentists, doctors, pharmacists, and optometrists to provide services to members of NBA and by making such services available to members of NBA in return for an annual membership fee, is arranging for the provision of health care services to subscribers or enrollees in return for a prepaid or periodic charge.

During the years following the Commissioner's NBA opinion, and in large part due to the Internet, so-called discount membership entities have dramatically proliferated. Many of these entities market discount health services to employers, insurers, health care service plans, and individual members of the public, both within and outside the State of California. Some discount membership programs contract individually with providers to obtain contractual discounts for their members. Others contract with networks of providers. Some discount membership programs offer discounts on a single type of health care service, most commonly dental. Others offer discounts on a combination of health care services which may include vision, chiropractic, pharmacy, acupuncture, podiatry, physician and/or hospital services. Some programs offer discounts only on health care services, while others offer discounts on other types of services as well.

The common attributes of these discount membership programs are that they (1) charge fixed-rate periodic membership fees, generally monthly or annual, without regard to the volume of health care services, if any, accessed by the member; (2) arrange for members to receive discounts on health care services received from plan providers; (3) provide their members with lists of participating plan providers; and (4) are not involved in the member's decision to access providers or the provision of health care services. All contracts for health care services are formed directly between the member and the provider. Program providers bear sole responsibility for providing the health care services, and members bear sole responsibility for payment of the discounted fees for the services. The programs typically promise only that members will receive a discount on the fees charged by participating providers for any services the member may choose to seek.

Pursuant to the NBA opinion, such discount membership programs must be licensed under the Knox-Keene Act in order to charge membership fees for providing discounts on health care

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[2] NBA proposed to add a statement to its member booklet: "Your membership fee is for the discount buying services only. NO PART of this fee includes charge for the use of the Legal, Dental, Medical/Physician, Prescription Drug or Vision Care programs. Such programs are provided as an additional no cost service to you. Your decision to join the NBA program should not be made because of the availability of these discount services." Despite this statement, the Commissioner determined that "any benefit or services given or delivered with, or as a bonus on account of, any purchase of a membership constitutes a part of the subject of the purchase," and that the membership fee would therefore constitute a prepaid or periodic charge for the health care service discounts within the meaning of section 1345(f)(1).

services in California. It is difficult, however, for such entities to meet the regulatory licensure requirements. Especially difficult is the requirement of section 1375.1, mandating that every plan assume "full financial risk on a prospective basis for the provision of covered health care services." By their very nature, discount membership programs assume no financial responsibility for the provision of health care services. In order to be licensed under the Knox-Keene Act, discount membership programs must ordinarily carry out a substantial restructuring of their operations.

The need to restructure operations as a condition precedent to an entity's licensure is not, in and of itself, remarkable. Virtually any entity seeking a Knox-Keene license needs to carry out extensive modifications to its operations in order to comply with all of the regulatory requirements of the Act. Some entities meeting the definition of a health care service plan specified in section 1345(f)(1) find it impossible to satisfy the regulatory licensure requirements, and are therefore unable to lawfully operate in California. There is nothing inherently inconsistent about an entity falling within the licensing requirement yet finding it impossible to qualify for a license. As stated in Commissioner's Opinion 6095H:

> It is of no consequence for jurisdictional purposes that a person within the definition of "health care service plan" does not or cannot comply with regulatory provisions directed at licensed health care service plans. This merely evidences legislative intent to prohibit certain kinds of business arrangements.

In the case of discount membership programs, however, the regulatory requirement of assuming full financial risk is so inconsistent with the essential feature of the type of business arrangement involved, that the Director has determined it appropriate to reconsider whether these entities fall within the definition of a "health care service plan" as defined in section 1345(f)(1).

There can be no serious dispute that the periodic membership fee charged by such a program does constitute a "prepaid or periodic charge" within the meaning of section 1345(f)(1). The pertinent prong of the definition is therefore the phrase "undertakes to arrange for the provision of health care services." More specifically, since it is indisputable that membership programs contract to provide discounts on health care services, the pertinent inquiry is whether "arranging for the provision of" <u>discounts</u> on health care services is equivalent to "arranging for the provision of" health care services.

The meaning of the term "undertaking to arrange for the provision of health care services" has been analyzed previously in a series of Commissioner's opinions, Nos. 6095H, 4664H and 4730H, each of which contains the following passage on the subject:

> In this connection, section 1399.5 of the Act uses the phrase 'provides, administers or otherwise arranges.' That phrase does not refer to the performance of only purely ministerial functions in connection with another person's obligation to provide, arrange for the provision of, or pay for any part of the cost of, health care services, but rather refers to the activity of a person primarily or secondarily obligated to exercise discretion in securing health care services through contracts with providers or

> otherwise. (See Comm. Op. 79/3H.) Such an obligation is set forth in a 'plan contract,' which is defined in the Act to mean a contract between a plan and its subscribers or enrollees or a person contracting on their behalf pursuant to which health care services are furnished. As indicated in Comm. Op. 78/6H, the phrases 'to arrange' and 'provides, administers or otherwise arranges' are entirely consistent: the latter phrase, used in section 1399.5, merely demonstrates the breadth of the term 'to arrange' used in section 1345(f).

Regardless of how broad the term "arrange" may be used in the Knox-Keene Act, the fact remains that in the case of discount membership programs, the contract between the entity and its subscribers or enrollees (or person contracting on their behalf) does not "arrange" for the provision of health care services at all. Instead, arrangements for the provision of health care services are made directly between the member and the provider. The entity arranges only for a discounted rate for whatever health care services the member chooses to access on his or her own from a participating program provider.

This conclusion is consistent with the substantive provisions of the Knox-Keene Act as well as with its jurisdictional definition of a "health care service plan." The comprehensive licensing and regulatory framework of the Knox-Keene Act is directed at ensuring that entities which accept responsibility for providing and paying for health care services needed by their subscribers and enrollees have the financial solvency and administrative capacity to provide access to those services in a manner that ensures their quality and continuity.

Discount membership programs, on the other hand, provide no health care services, pay for no health care service, and assume no responsibility for the quality of any care provided to their members by participating providers. Their only promise to members is that participating providers have agreed to make their services available to plan members at discounted rates. The requirements of the Knox-Keene Act which regulate the quality of care offered by health plans are therefore inapplicable to them. A member who is dissatisfied with the care received from a participating provider has recourse to the appropriate licensing authority for that category of health service provider.

Similarly, since the program undertakes no financial obligation to pay for members' care, its financial insolvency does not threaten the members' access to care or the program providers' ability to provide it. If a discount membership program becomes insolvent, the member can still continue to access the same care through the same providers, albeit at the non-discounted fee. The maximum financial loss to the member in the event of insolvency is the amount of the most recent membership fee payment. The requirements of the Knox-Keene Act which regulate the financial solvency of health care service plans are therefore largely inapplicable to discount membership programs.

This is not to say that discount membership programs do not warrant regulation. As a group they raise a number of consumer protection concerns, first and foremost is assuring the legitimacy of the promised discount. The discounts offered by membership programs may be illusory, inadequately explained, duplicative of other coverage, or no better than what non-members could obtain from other sources without payment of a membership fee. Alternatively, discount membership programs may misrepresent the size or geographic

distribution of their provider networks, thereby misleading consumers. Many discount membership programs are sold through multilevel marketing arrangements which give rise to additional concerns about the accuracy and completeness of program information available to prospective members. Unscrupulous discount operations may target their marketing and solicitation efforts at low income and the elderly who are particularly vulnerable to promises of cheaper health care services and for whom the membership fees constitute a significant expense. Discount programs typically engage in no review or investigation of the quality of the services offered by their providers, leaving that matter to be assessed by the members on their own. These are significant issues. Nevertheless, the complex licensing and regulatory framework of the Knox-Keene Act is ill-adapted to address them because its provisions are largely devoted to regulation of activities with which the discount programs are not involved.

It is the conclusion of the Director that discount membership programs are not engaged in "arranging for the provision of health care services" when and to the extent that they contract to obtain fee discounts on services their members choose to receive from participating program providers. Accordingly, it is hereby ordered that Commissioner's Opinion No. 4614H is rescinded and no longer constitutes the position of the DMHC. However, the DMHC will continue to regulate the offering of discounts on health care services by licensed Knox-Keene plans whether such programs are offered directly or indirectly through contracts with discount health care programs.

Dated: June 7, 2001
Sacramento, California

By order of
DANIEL ZINGALE
Director of the Department of Managed Health Care

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DANIEL ZINGALE